

MINUTES OF THE REGULAR MEETING OF THE ARIZONA STATE RETIREMENT SYSTEM BOARD

**HELD ON
November 15, 2002
10:00 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in The Arizona Room of the Hassayampa Inn, 122 E. Gurley Street, Prescott, Arizona. Mr. Alan Maguire, Chairman, Arizona State Retirement System Board, called the meeting to order at 10:05 a.m., MST.

The meeting was teleconferenced to the ASRS offices at 3300 N. Central Avenue, Phoenix, Arizona 85012, and 7660 East Broadway Boulevard, Suite 108, Tucson, Arizona 85710.

1. Call to Order; Roll Call

Present: Mr. Alan Maguire, Chairman
Mr. Bonnie Gonzalez, Vice Chairman
Ms. Charlotte Borchert
Mr. Jim Bruner
Dr. Chuck Essigs
Mr. Norman Miller
Mr. Karl Polen (via telephone)
Mr. Ray Rottas
Mr. N. Carl Tenney

A quorum was present for the purpose of conducting business.

2. ASRS Overview; Perspective of the last 50 years

The ASRS made a presentation to an audience of employer representatives from Yavapai and Coconino counties. The review included the following items:

- Benefits of being a Member of the ASRS
- Investments and Financial Stability of the ASRS
- The Future of the ASRS

3. Presentation and Discussion of ASRS Benefits

The ASRS staff presentation included a listing of employer services, active member services, and retired member services, which include the following:

- Defined Benefit Plan
- Survivor Benefits
- Long Term Disability Insurance

- Service Purchase Program
- Health Insurance for Retirees
- Permanent Benefit Increase
- Graded Multiplier

Also outlined were ongoing service improvements which include, technology updates, including document imaging, website enhancements, on-line account information, and call center and telephone upgrades. Member benefit protection is also an ongoing commitment.

4. Presentation and Discussion Regarding the Protection and Investment of ASRS Assets

The ASRS assets under management as of October 31, 2002, total \$17,448,304,043. The Board approved ASRS asset allocation is 53% domestic equities, 30% domestic fixed income, and 17% international equities. The broad asset allocations as of October 31, 2002 are:

- Total Portfolio Actual Mix
 - Domestic Equity 54.7%
 - Fixed Income 29.6%
 - International Equity 15.7%
- Total Portfolio Assumed Mix
 - Domestic Equity 52.5%
 - Fixed Income 31.8%
 - International Equity 15.7%

5. Presentation and Discussion Regarding Future Issues Affecting the ASRS, Participating Employers, and Members

The ASRS contribution rates, past and future, were presented to the Board and public.

Staff explained that a Permanent Benefit Increase (PBI) for ASRS Retirees increases the base retirement benefit to lessen the impact of inflation. The PBI is given by two methods; excess earnings, or ad hoc.

The excess earnings PBI is calculated by the Actuary and based on ASRS earnings in excess of 8%. This type of PBI is not to exceed 4% annually. The calculated amount is then applied to the member's pension benefit by the following formula: years of service X dollar amount = PBI.

The Enhanced Permanent Benefit Increase (EPBI) is based on the interest on the excess funds for the PBI. The Actuary calculates a dollar amount to be applied; this amount is based on the number of years since retirement date. The EPBI is applied to the member's benefit by the following formula: Pension + BPB + EPBI = New Benefit.

The ad hoc PBI is a benefit increase authorized by law in an amount to be determined at the time it is granted. Example: The increase given in 2000 when all retirees received a 5% increase to equal the 2.1% multiplier increase granted to active members.

The order of the meeting was changed to accommodate any questions that the public may have.

6. Call to the Public

No members of the Phoenix or Prescott public addressed the Board. Three members of the Tucson public addressed the Board. Ms. Susan Waites, representing the Tucson Education Association expressed her dismay over the change of venue for the November meeting. The November meeting has been held in Tucson in past years. Dr. Robert Letson, representing the University of Arizona Retirees Association, complimented the Board on their research into the retiree health insurance issues. Dr. Letson also commented that he would like to see the 2001 annual report on the web site, and he asked about the status of the retiree advisory committee that is mentioned in the ASRS Strategic Plan, as there are several legislative issues that are of importance to retirees. Mr. Bob Peltier, representing the Pima County Retirees Association, commented on the procedure of the Call to the Public at the ASRS Board meetings.

Mr. Maguire called a recess of the Board meeting at 11:15 a.m.

The Board reconvened to regular session at 11:50 a.m.

Mr. Karl Polen was excused from the meeting at 11:50 a.m.

Mr. Norman Miller questioned if this meeting was posted legally and questioned whether the meeting should be discontinued and the business at hand deferred to a special meeting of the Board.

Mr. Fred Stork, Assistant Attorney General, stated that meeting notices are required to be posted with the Secretary of State, on the 14th and 1st floors of the ASRS Phoenix office at 3300 N. Central Avenue, and at the Tucson office, 24 hours prior to a meeting. Mr. Stork personally vouched for the fact that the notices were posted properly in the Phoenix office, and staff confirmed that the notice was posted in the Tucson office at 3:22 p.m., Wednesday, November 13, 2002. Therefore, Mr. Stork said that the November 15, 2002 meeting of the Board was in compliance with Arizona Open Meeting Law.

7. Approval of Minutes of the October 18, 2002, Regular Meeting of the ASRS Board

Motion: Ms. Bonnie Gonzalez moved to approve the minutes of the October 18, 2002, regular meeting of the ASRS Board.

Mr. Ray Rottas seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

8. Approval of Consent Agenda

- A. Approval of Retirements, Refunds and Death Benefits
- B. Approval of System Transfers
- C. Application and Agreements with the Following Employers:
 - Mohave Accelerated Learning Center
- D. Approval of Contract Extension of Buck Consultants for Actuary Services
- E. Approval of Contraction Extension of Investment Contracts for Small Cap Equity Managers

Motion: Ms. Bonnie Gonzalez moved to approve the retirements, refunds, death benefits, system transfers, application and agreement with Mohave Accelerated Learning Center, and the one year contract extension of Buck Consultants for actuary services.

Dr. Chuck Essigs seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

Motion: Mr. Alan Maguire moved to extend for one year the contracts for Small Cap Equity Management to Byram Capital Management, Columbia Management, Dimensional Fund Advisors, Mellon Capital Management, Strong Capital Management, and Batterymarch.

Mr. Jim Bruner seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

9. Director's Report

For the benefit of new meeting attendees, Mr. Gilbertson explained that the Director's Report contains reports regarding the operations of the ASRS. It also contains special reports of any issues that may be timely to the ASRS and its members.

Mr. Maguire commented on the status of the Supplemental Retirement Savings Plan (SRSP) and the Deferred Retirement Option Program (DROP), stating that the Internal Revenue Service (IRS) indicated it plans to rule negatively on the final determination of the private letter ruling allowing the SRSP and DROP as proposed by the ASRS. Mr. Maguire, Mr. Anthony Guarino, Deputy Director, Chief Operations Officer, and Mr. Charles Whetstine, ASRS Tax Attorney, met with representatives of the IRS to discuss the issue. The ASRS now has until December 5, 2002 to amend the private letter ruling to make it more favorable to the IRS. If the private letter ruling is amended, it may also be necessary to amend the state law authorizing the SRSP and DROP.

Mr. Miller asked that Mr. Richard Stephenson, Deputy Director, External Affairs, open a bill at the beginning of the legislative session allowing the ASRS to amend legislation regarding the SRSP program if needed.

10. Presentation, Discussion and Appropriate Action Regarding the Executive Search Committee Status

Mr. Maguire reported that the Search Committee will meet at 1:30 p.m., following the Board meeting, to review the applications that were received for the Director position. Exploratory visits will then be held with several of the applicants to identify the leading candidates, followed by final interviews.

11. Presentation, Discussion and Appropriate Action Regarding Calculation and Treatment of “13th Check” for “System” Retirees

Mr. Charles Chittenden, Actuary, Buck Consultants, explained that the 13th check is a result of earnings in excess of the actuarially estimated 8%. This year resulted in a negative excess that will need to be allocated among the System retirees. Mr. Chittenden proposed several options on how the ASRS could handle the 13th check and the negative amount that will affect some retirees.

Following discussion regarding the Statute governing the 13th check, the Board determined to obtain an actuarial analysis and a recommendation from legal counsel regarding the options available to the Board.

Mr. Maguire stated that a special Board meeting would be held within seven to ten days to hear the results of this analysis and make a determination.

12. Presentation, Discussion and Appropriate Action Regarding the Actuarial Valuation of the Arizona State Retirement System for the Period Ending June 30, 2002

Mr. Chittenden and Ms. Eva Yum presented the June 30, 2002, Actuary Valuation which contained the following information. The report also contained the proposed numbers after the emergency rule amendment as proposed on the next agenda item.

- Active Member = 198,870; Retired Members = 60,346
- Active Payroll = \$6,989
- Average Annual Salary= \$35,145; Average Annual Benefit = \$16,452
- Actuarial Value of Assets = \$22.313B; Market Value = \$18.595B; Actuarial (Method Change) = \$23.623B
- Estimated Actuarial Yields on Assets = .64%; Market Yields = -11.29%; Actuarial (Method Change) = 6.36%
- Contributions = \$322 M; Benefits and Refunds = \$1,044M
- External Cash Flow as Percentage of Market Value = -3.88%
- Unfunded Actuarial Accrued Liabilities = \$273M; Actuarial (Method Change) = (\$1,036M)
- GASB #25 Funded Ratio (401a Only) = 100.5%; Actuarial (Method Change) = 106.4%
- Permanent Benefit Increase = \$35.43
- Retirement Contribution Rate for the Plan Year = 6.11%; Actuarial (Method Change) = 5.20%

- LTD Contribution Change for the Plan Year = .50%, Actuarial (Method Change) = .50%
- Total Employee Contribution - 5.70%; Total Employer Contribution – 5.70%

The motion to accept the actuarial valuation of the Arizona State Retirement System for the period ending June 30, 2002, was deferred until the motion regarding the emergency rule amendment to R2-8-123, Actuarial Assumptions and Actuarial Value of Assets, was made.

13. Presentation, Discussion and Appropriate Action Regarding Emergency Rule Amendment to R2-8-123, Actuarial Assumptions and Actuarial Value of Assets

An emergency rule amendment to R2-8-123 was presented to the Board. This amendment would change subsection (2) of the rule. The subsection currently establishes the actuarial value of the ASRS plan assets as equal to the market value of assets less a five-year phase-in of the difference between expected and actual investment returns. It further restricts the resulting value to not less than 80% nor more than 120% (a 20% corridor) of the market value of assets.

A substantial portion of the (plan's) assets are invested in securities. Even though the securities market may represent a sound long term investment, it is subject to more short term, sudden and wide swings in value. Contribution amounts of employers and employees are calculated annually and are a function of actuarial assets (including market gains and losses) and liabilities. Investment gains and losses are currently recognized actuarially over a five-year period for the purpose of "smoothing" the annual changes in contribution rates resulting from market gains and losses. Actuarial calculations show that using the current five-year smoothing and 20% corridor would result in contribution rates jumping from the current 2.00% to 6.17%.

If we eliminate the 20% corridor, the contribution rate would decline from 6.17% to 5.51%. If we also extend the "smoothing" period from five to ten years, it will cause the contribution rate to further decline from 5.51% to 5.20%.

Motion: Ms. Bonnie Gonzalez moved to approve the emergency rule amendment to R2-8-123, Actuarial Assumptions and Actuarial Value of Assets.

Ms. Charlotte Borchert seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

Motion: Ms. Bonnie Gonzalez moved to accept the Actuarial Valuation of the Arizona State Retirement System for the period ending June 30, 2002, prepared in accordance with the changes in the actuarial assumption method approved in the emergency rule amendment to R2-8-123.

Mr. Carl Tenney seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

This motion sets the retirement contribution rate at 5.20% and the LTD contribution rate at .50% for a total of 5.70% each for employers and employees.

14. Presentation, Discussion and Appropriate Action Regarding the Schedule for Meetings of the ASRS Board for the Calendar Year 2003

The Board meetings for Calendar Year 2003 will continue to be held on the third Friday of each month.

15. Board Requests for Agenda Items

Mr. Miller asked that an update be given on the ASRS Board governance RFP process.

16. The next ASRS Board meeting is scheduled for Friday, December 20, 2002 at 8:30 a.m. in the 10th floor Board Room of the ASRS Phoenix Office, 3300 North Central Avenue, Phoenix, Arizona 85012.

17. Adjournment of the ASRS Board.

Mr. Alan Maguire, Chairman, adjourned the November 15, 2002, meeting of the ASRS Board at 1:05 p.m.

ARIZONA STATE RETIREMENT SYSTEM

Gayle Norman, Secretary

Date

LeRoy Gilbertson, Director

Date